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# OVERVIEW OF HIGH TECHNOLOGY TAX PROVISIONS
# ACT 178, SLH 1999, Relating to Technology
# And ACT 297, SLH 2000, Relating to the New Economy
# Prepared by DOTAX, State of Hawaii

- **ACT 178** helped spur economic development and foster the growth of knowledge-based industries in Hawaii by:
  - Consolidating the State's high technology agencies,
  - Integrating technology with the tourism industry,
  - Focusing on work force development programs,
  - Providing access to the Internet for the University of Hawaii and public schools, and
  - Enacting tax incentives.

- **ACT 297** will encourage high technology development by:
  - Allowing the Board of Trustees of the Employees' Retirement System to invest in venture capital for high technology businesses,
  - Creating the Hawaii Technology Investment Program for small individual investors,
  - Providing additional funding for various educational programs,
  - Providing increased autonomy for the High Technology Development Corporation, and
  - Providing additional tax incentives.

## TAX PROVISIONS

- **Hawaii Internet Tax Freedom Act** (patterned after federal ITFA) imposes a six-year moratorium on any **"discriminatory tax"** on electronic commerce or Internet access under the income tax law, general excise tax law, and use tax law. For six years starting in 2000.

- **New R&D credit** conforms Hawaii law to the 20% federal R&D income tax credit under section 41 of the Internal Revenue Code for increased R&D expenses except that the research must be done in Hawaii and the credit is **refundable**. Available for tax years 2000-2005 even if the federal credit is repealed during this period.

- **Sale of unused net operating loss** by a qualified high technology business ("QHTB") to another taxpayer is allowed provided the sale is approved by the Department of Taxation, the sale is for an amount equal to at least 75% of the amount of the surrendered tax benefit and the sale does not exceed $500,000 per year. This applies only to NOLs occurring in the two taxable years preceding the year in which the sale of the NOL carryover occurs. The amount received by the seller is not taxable. (Effective for sales in tax years 2001-2003.)

  An application for the sale of an NOL won't be approved if the seller in any of the two previous years:
  (1) Had a positive net income;
  (2) Had a ratio of more than 110% of operating revenues divided by operating expenses;
  (3) Is 50% owned by another corporation that had positive net income; and
  (4) Is part of a group of affiliate corporations that in the aggregate had positive net income;
  as certified by a licensed CPA.

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**QHTB** is defined as a business that conducts more than 50% of its activities in qualified research ("QR"). Areas disqualified from QHTB status include law, architecture, accounting, athletics, financial services, etc. (negative definition).

**QR** is defined as:

(1) R&D work per section 41(d) of the Internal Revenue Code;
(2) The development and design of computer software--must use fourth generation or higher software development tools or native programming languages to design and construct unique and specific code to create applications and design databases for sale or license; or
(3) Biotechnology--fundamental knowledge regarding the function of biological systems from the macro level to the molecular and subatomic levels with application to development including the development of novel products, services, technologies, and subtechnologies from insights gained from research advances that add to the body of fundamental knowledge.

- **Stock option income (ordinary and capital gains)** received by an employee, officer, or director of a QHTB, or by an investor in a QHTB which investory qualifies for the QHTB investment credit, is **exempt** from the **income tax** beginning tax year 2000 (no sunset). Exemption applies to income received from income earned and proceeds from sale of stock received on the exercise of stock option.

- **Royalties and other income derived from patents, copyrights or trade secrets excluded** from **income tax** beginning tax year 2000 (no sunset). Patents, copyrights and trade secrets must be owned by an individual or QHTB and have been developed and arisen out of a QHTB. For royalty income, QR also includes "performing arts products." "Performing arts products" defined as:
  (1) Audio files, video files, audiovideo files, computer animation, and other entertainment products perceived by or through the operation of a computer; and
  (2) Commercial television and film products for sale or license, and reuse or residual fee payments from these products.

- **High-technology business investment tax credit** provides a nonrefundable income tax credit for an investment in a QHTB. For this provision only, a QHTB is a business employing or owning capital or property, or maintaining an office in Hawaii where:
  (1) More than
    (A) 50% of whose total business activities are QR; and
    (B) 75% of the QR must be conducted in Hawaii; or
  (2) More than 75% of whose gross income is derived from qualified research; provided that this income is received from:
    (A) Products sold from, manufactured in, or produced in Hawaii; or
    (B) Services performed in Hawaii.

  The credit is equal to **10%** of the investment made, up to a maximum credit of $500,000 ($5M investment) per year per business. Credit can be taken against the income tax, insurance premium tax, and franchise tax (financial institutions) for tax years 1999-2005 for investments on or after July 1, 1999. Federal restrictions on partners' allocation of credits don't apply to the investor.

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- **The capital loss carryforward** period for QHTBs has been increased from five years to 15 years beginning tax year 2000 (no sunset). QHTB in this case is defined the same as for royalty exclusion.

- **High Technology Investment Program** established for small investors in QHTBs; dividend and gain distributions exempt from income tax.

- **Additional technology-related measures from the 2000 Legislative Session:**

  - **ACT 118 (S.B. 2779, C.D. 1) -** Expands the enterprise zones law to include call centers[1] (and businesses engaged in research, development, sale, or production of all types of genetically-engineered medical, agricultural, or maritime biotechnology products, and businesses that repair assisted technology equipment).

  - **ACT 195 (S.B. 2781, C.D. 1) -** Exempts from general excise and public service company taxes amounts received by a telecommunications common carrier from a person operating a call center.[2] (Drops dead on June 30, 2010). Also provides a refundable 4% income tax credit for hotel construction and remodeling (e.g., hotel upgrading infrastructure with wiring to provide guests with Internet access) for years 1999-2002.

  - **ACT 237 (S.B. 2420, C.D.1) -** Establishes a New Economy Technology Scholarship Program to create a pool of highly trained technology workers to improve the State's ability to attract and retain business; and to encourage Hawaii students to pursue higher education and training in science and technology fields, essential to economic development in Hawaii.

- **Recent Tax Legislation Benefitting the Hi-Tech Industry:**

  - **ACT 70 SLH 1999** provides for exported services exemption and use tax on imported services.

  - **ACT 71 SLH 1999** provides for phased-in tax relief for wholesale sales of services.

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[1]For this section, "call center" means a business providing service at an establishment in which customer and technical support services for manufacturing companies, computer hardware and software companies, credit collection services, product fulfillment services, or disaster management services, are provided by telephone. It does not include telemarketing or sales.

[2]For this section, "call center" means a physical or electronic operation that focusses on providing customer service and support for computer hardware and software companies, manufacturing companies, software service organizations, and telecommunications support services, within an organization in which a managed group of individuals spend most of their time engaging in business by telephone, usually working in a computer-automated environment. It does not include telemarketing or sales.